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C O N F I D E N T I A L SECTION 01 OF 04 KYIV 002165

SIPDIS

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TAGS: [ECON](#) [PGOV](#) [ENGR](#) [PREL](#) [EFIN](#) [UP](#)

SUBJECT: UKRAINE: TYMOSHENKO RUNS ON POPULIST ECONOMIC POLICIES

REF: A. KYIV 2124

[B.](#) KYIV 2110

[C.](#) KYIV 1874

Classified By: Classified By: Economic Counselor Edward Kaska for Reasons 1.4 (b, d).

[¶](#)1. (SBU) Summary. Although the presumed heir of the Orange Revolution's reform banner, Prime Minister Tymoshenko has not made a liberal economic platform a part of her current campaign for Ukraine's presidency. Instead, her platform promises a strong role for the state, both in the social sector and in economic development. While trumpeting her success in negotiating long-term gas contracts with Russia, the Prime Minister simultaneously sees subsidies to support the coal sector as the way to Ukraine's energy security. As part of a promised war against corruption, Tymoshenko would renationalize assets privatized under previous governments, although as Prime Minister she has done little in that regard. While Tymoshenko claims she has ably managed the GOU's response to Ukraine's economic crisis, her critics claim otherwise, and point to the Prime Minister's management style and economic populism as key factors in the GOU's failure to undertake the reforms needed to create conditions for the recovery and long-term health of Ukraine's economy. End summary.

[¶](#)2. (U) This is the third in our series reporting on the economic platforms of Ukraine's presidential candidates (Ref A and B).

Crisis Management and the IMF

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[¶](#)3. (SBU) Prime Minister Tymoshenko has framed her election campaign with the slogan "she works," and her advisors point to her claimed able management of the financial crisis as proof of her capabilities. Election campaign chairman Yaroslav Fedorchuk told us on November 24 that Tymoshenko had prevented a complete collapse of the banking sector, despite the many difficulties she had encountered. "We saved the banks," Fedorchuk said. He claimed that while there are still some problems in the banking sector, including interest rates that are "too high," the system is working.

[¶](#)4. (SBU) Asked about the IMF program, Fedorchuk said that Tymoshenko faced a stark choice: either to borrow from the IMF or see the economy collapse. He said that "rational and realistic" voters, in contrast to Party of Regions and Communist voters, will understand the benefits of Ukraine's cooperation with the IMF. Tymoshenko's victory would demonstrate that there are more rational voters in Ukraine than irrational ones, according to Fedorchuk.

¶ 15. (SBU) Under a Tymoshenko presidency, cooperation with the IMF would continue, although the government would try to limit the number of "negative features" of the program, Fedorchuk stated. He added that the IMF money should go to economic programs that would spur economic recovery, such as developing the aviation and agricultural sectors.

¶ 16. (SBU) The IMF and many in the international community, however, have criticized Tymoshenko for not following the conditions of the IMF program. Tymoshenko has not enacted reforms called for by the IMF, including increasing gas prices and reforming Ukraine's unsustainable pension system. Tymoshenko's political opponents charge that the nearly \$11 billion disbursed by the IMF has been wasted by Tymoshenko's government.

Role for the State

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¶ 17. (SBU) Fedorchuk stated that as president, Tymoshenko would guide Ukraine's economy with a strong hand. According to him, Ukrainian society had formed under socialism, and Ukrainians are not yet able to fight for themselves in a market economy. The state needs to intervene in the market to protect the welfare of its citizens. Fedorchuk added that the state should participate in the development of the economy itself, pointing toward U.S. economic policy during the Great Depression and economic policy in the U.S. and Europe today as rationale for Tymoshenko's approach. The bottom line, according to Fedorchuk, is that Ukraine is not prepared for a liberal market economy now.

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¶ 18. (SBU) Fedorchuk specifically pointed to Ukraine's health care and pension systems as inadequate social protection systems. Tymoshenko, if elected president, would work to create a health insurance system that would provide all Ukrainians with coverage and lower health care spending, according to Fedorchuk. Asked if Tymoshenko would act to annul a recently passed increase in minimum wages and pensions, Fedorchuk stated that the Block of Yulia Tymoshenko (BYuT) supports the increases to pensions and wages. Pensions and wages should be raised based on GDP growth, he said. Tymoshenko's platform promises that as president she would enact a law requiring minimum wages be raised to at least 60% of companies' cost of production. (Note: The weekly magazine "Kommentari" included this campaign promise in its list of the ten oddest presidential campaign promises. End note.) Fedorchuk repeated "We cannot be a liberal economy. We need to be realistic."

Privatization Policy to Ensure State Wealth Protected

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¶ 19. (SBU) The state's role would also extend to ensuring fairness and transparency in the privatization of state assets, Fedorchuk told us. The development of Ukraine's economy cannot be talked about as long as the wealth of the state is being "stolen," he said. Fedorchuk complained that post-independence economic policies created a "mafia-like environment" in Ukraine. In her campaign platform, Tymoshenko calls Ukraine's oligarchs a "cancer on modern Ukraine." (Note: Given the fact that Tymoshenko's campaign is also financed by oligarchs, this is a rather incongruous campaign promise aimed at the oligarchs who support opposition leader Viktor Yanukovych. End note.)

¶ 10. (SBU) Fedorchuk pointed to the June 2004 privatization of Kyrvoizhstal under then-President Kuchma as an example of this "mafia" environment. The steel company was sold to Rinat Akhmetov's Systems Capital Management and Victor Pinchuk's (Kuchma's son-in-law) Interpipe for \$800 million, well under what international analysts had stated was the value of the company. Under PM Tymoshenko's government in 2005, the privatization deal was cancelled. A new bid

process for the plant concluded in October 2005 with Mittal Steel paying \$4.81 billion for the company. As president, Tymoshenko would continue her efforts to ensure that Ukraine receives top dollar for state assets, Fedorchuk promised.

¶11. (SBU) Fedorchuk stated that Tymoshenko would not take away property based on personal vendettas. On December 4, the Prime Minister stated she had a list of businessmen "that one must begin with in starting the fight against corruption." She said that Ukraine needs to finish with them for what "they have done to the country over the past 18 years." In 2005, Tymoshenko announced that she planned on renationalizing 3,000 businesses that had been privatized since Ukraine's independence, but has done little in that regard as Prime Minister. Fedorchuk also stressed that investors should implement privatization commitments.

#### Conditions for Foreign Investment Must be Created

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¶12. (SBU) Fedorchuk welcomed the direct investment of foreign, and especially American, companies in Ukraine. However, he said, before foreign investment would be attracted to Ukraine, order must be established inside the country. Fedorchuk stated that Tymoshenko would work to create attractive conditions for investors, although he did not offer specific steps that Tymoshenko would take to attract investment. In her campaign platform, Tymoshenko proposes tax holidays for investments in depressed regions and new production facilities. Fedorchuk also proposed that Ukraine's value added tax (VAT) be replaced with a "turnover," or sales, tax. Fedorchuk claimed that such a change would significantly reduce the cost of selling goods in Ukraine.

#### Ukraine's Energy Independence Brought to You by Coal

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¶13. (SBU) Energy independence and improved gas relations with Russia are key points of Tymoshenko's campaign platform. The platform promises to introduce energy-saving technologies and reduce Ukraine's dependence on foreign energy sources. The key to energy independence, as Tymoshenko outlined in her campaign kick-off speech on October 24 (Ref C), is greater

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reliance on Ukrainian coal. Fedorchuk stated that Ukraine needs to develop the coal sector and switch its electric generation and municipal heating facilities from Russian gas to domestically produced coal. While Ukraine's domestically produced energy grade coal is more expensive than coal from Poland or Russia, Fedorchuk stated, it is better to subsidize the coal sector than pay a high price for Russian gas.

¶14. (SBU) To support the development of the coal sector, Tymoshenko proposes a UAH 12.6 billion subsidy to the coal sector and an additional UAH 5.6 billion in state loan guarantees for 2010. The total allocation of UAH 18.2 billion for the coal sector is almost double the value of expected 2009 production from state-owned coal mines (production in the first half of 2009 was UAH 5.5 billion).

¶15. (SBU) Tymoshenko heralds the January 19, 2009 gas supply and transit contracts with Russia as important steps forward in Ukraine's relationship with Russia. The contracts cut out shady gas-intermediary RosUkrEnergo and established a fixed formula for gas prices. Although the contracts have been widely criticized by President Yushchenko and Party of Regions' leader Viktor Yanukovych, Tymoshenko has stated that the contracts provide stable relations with Russia and do not need to be revised. Fedorchuk, however, stated that Ukraine is taking less gas than envisioned by the contracts not only because of the drop in demand caused by the economic crisis but also to reduce Ukraine's energy dependence on Russia.

¶16. (SBU) Tymoshenko has placed less emphasis on the

development of Ukraine's oil and gas reserves than on coal sector development during her campaign. In her campaign kick-off speech on October 24, Tymoshenko pledged to protect the Black Sea's oil and gas deposits from foreign hands (Ref C). Fedorchuk repeated Tymoshenko's pledge and charged that the tender that awarded a Black Sea block to the American firm Vanco International would have deprived Ukraine of production revenues. Fedorchuk claimed that President Yushchenko was linked to this "corrupt" deal.

¶17. (SBU) Although Tymoshenko has pledged to the EU and several international financial institutions that she would reform the gas sector, her government has not yet taken steps forward on reform. Fedorchuk explained that energy sector reform will be part of a larger reform effort of the economy. He also acknowledged that without energy reform, Ukraine will not become independent from outside actors.

Tymoshenko's true intentions on gas sector reform, however, are hard to read. On November 25, the Prime Minister said that the gas price for industry would not increase in the first quarter of 2010. However, the January 2009 gas supply contract with Russia stipulates that as of January 1, 2010, Ukraine will no longer receive a 20% discount on Gazprom-supplied gas. Tymoshenko has also pledged to keep in place discounts on the gas price paid by Ukraine's struggling chemical sector.

#### Criticism of Tymoshenko's Management Style

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¶18. (C) Although Tymoshenko's campaign has stressed that she has effectively managed the economic crisis, Tymoshenko and her economic policies have not escaped criticism, even from within her party. Yuriy Poluneev, a BYuT MP, told us on November 27 that Tymoshenko and BYuT do not have an economic policy or any formal decision-making system. Rather, according to Poluneev, the Prime Minister takes an ad hoc approach and makes decisions by herself. Poluneev said that the budget has been "manually" controlled by the Prime Minister since the summer.

¶19. (C) Poluneev's comments mirror critiques of the Prime Minister from other analysts. Oleksandr Todiichuk, former chairman of UkrTransNafta, described Tymoshenko as very emotional. He said that a top complaint at Naftohaz for several months has been the Prime Minister's "manual control" of the company. Economics and energy reporter Alla Veryomenko from the weekly paper "Dzerkalo Tizhnya" told us that Tymoshenko's character is at its essence authoritarian. While Yushchenko or Yanukovych can be influenced by their advisors, Tymoshenko takes decisions on her own, she said. Ivan Yurik, an Alfa Bank executive and economic advisor to former Minister of Finance Pynzenyk and former Minister of Economy Shpek, shared a similar appraisal with us on December ¶12. According to Yurik, Tymoshenko has deliberately avoided having an advisor on macroeconomic issues and makes all

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economic decisions on her own, usually without any counsel from experts.

¶20. (C) Aside from her management style, Tymoshenko is also criticized for her seeming lack of a basic understanding of economics fundamentals. Tymoshenko routinely states that the exchange rate has been artificially manipulated by conspirators. On December 14, Tymoshenko again promised that the exchange rate will rise to UAH 6: USD 1 within two months after she is elected president. Most experts, however, believe that the current rate (UAH 8: USD 1) is near equilibrium.

¶21. (C) Comment. Although Tymoshenko has painted herself as the heir to the Orange Revolution's reform agenda, her economic platform signals her underlying economic populism. Tymoshenko has formed policy positions, such as support for the development of the coal sector, to court key

constituencies. Her repeated promises to nationalize assets worry the business community. In addition, many business leaders are worried that Tymoshenko's continued "manual control" of the economy will thwart economic development and the conditions necessary to foster investment and trade. Given her past performance and underlying populist beliefs, Tymoshenko's promises to implement needed economic reforms as President do not ring true, and should be viewed with considerable skepticism. End comment.

TEFFT